Globalization

University of California San Diego (UCSD)

Econ 102

Catherine Laffineur

c.laffineur@hotmail.fr
http://catherinelaffineur.weebly.com

Introduction

- ▶ Arguments that goes in favor of free-trade is referred to an optimal world situation.

- ▶ However, a country can be incited to take advantage of protectionism in a precise period of time.

- ▶ There exists some cases where trade protection can be better than free-trade.

  - When the country is large enough to influence world price
  - When the producer abroad is a monopoly
  - When the competition is not pure and perfect

- ▶ This chapter will review the arguments for protectionism

The infant industry protection (1/2)

- ▶ In industrial countries, protection is more likely to be provided to labor-intensive industries or to industries with few firms.

- ▶ One argument for protection that stands is the infant-industry protection
    - A nation may have a comparative advantage in a commodity
    - But because of a lack of know-how or small level of output, the industry cannot compete successfully

The infant industry protection (2/2)

▶ Protection is then justified to establish and protect the domestic industry during its infancy until it can meet foreign competition
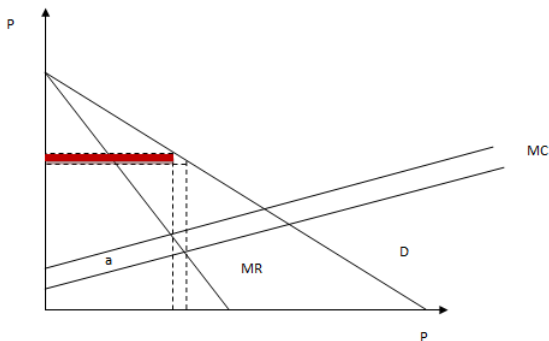
▶ The infant-industry argument is correct but requires several important qualifications:
- It is difficult to identify which industries qualify for this treatment
- What tariff protection can do, an equivalent subsidy can do better
  $\rightarrow$ but costly for developping countries

The model of Brander and Spencer

- ▶ There are two firms: 1 & 2 producing a quantity x and y of good
- ▶ The demand curve is as follows: $p = 5 - (x + y)$
- ▶ The competition is of Cournot type
  - Each firm maximizes its profit by considering the production of the other
- ▶ Both firms have the same cost function
  - $C_1 = 0.5 + 2x$
  - $C_1 = 0.5 + 2y$
- ▶ What are the two reaction functions?
- ▶ What happens after the subsidy?

Optimal protectionist strategy in the case of a Monopoly

- ▶ Assume a country that is relatively small and does not produce the good itself

- ▶ The good is supplied by a foreign monopoly

- ▶ Assume the country set up a tariff supported by the monopoly
  - For some demand functions, the consumer loss is lower than the government gain

Theory of Median Voter (1/2)

- ▶ Each agent has a fixed amount of labor and different amount of capital
- ▶ Individual utility depends on:
    - The level of protection in the country
    - The price of the goods consumed
- ▶ Voters differ in the policies they prefer
    - Suppose that policy can be described along a single dimension: the level of the tariff rate.
- ▶ Imagine a country exporting capital-intensive goods and imports labor-intensive goods
    - Voters with high capital levels will favor low tariff rates
    - Voters with high labor level will favor high-tariff rates (SS theorem)

Theory of Median Voter (2/2)

▶ Mayer shows that the level required by the median voter will be chosen by the collectivity

▶ There is a large inequality in the distribution of capital
- The median ratio $\frac{K}{L}$ is lower than the mean
- The median voter has a relatively high $\frac{L}{K}$ and will favor protectionist policies

Conclusion

▶ Traditional theory on protection are not well suited to the actual economic situation:

  ■ There exists oligopoly and monopoly
  ■ Strategic attitude about firm

▶ Some models have tried to justify protectionism: two ideas

  ■ Since there exists surplus in the case of imperfect competition some countries might benefit from protectionism by getting higher surplus

  ■ Since some groups of people are damaged by free-trade, the demand for protectionism may increase.